

MARINA COAST WATER DISTRICT

RESERVE FUNDS POLICY

MARINA COAST WATER DISTRICT RESERVE FUNDS POLICY

1. Policy Statement

A key element of prudent financial planning is to ensure that sufficient funding is available for current and future operating, capital, and debt service needs. Additionally, fiscal responsibility requires anticipating the likelihood of, and preparing for, unforeseen events. Marina Coast Water District (“District” or “MCWD”) will at all times strive to have adequate reserves to ensure that customers experience both stable rates for service and the security that the District can respond to emergencies, especially in connection with water and wastewater quality issues. Adequate reserves ensure that the District will at all times have sufficient funding available to meet its operating, capital and debt service cost obligations, together with the ability to fund future debt or capital obligations, as well as any unfunded mandates, including regulatory requirements.

The District manages its reserves to (i) permit funding consistent with its annually updated five-year capital improvement program and five year rate study financial plan; and (ii) avoid significant rate fluctuations due to changes in cash flow requirements. The ability of the District to maintain reserve funds is a critical factor in providing reliable service, mitigating rate increases and ensuring overall financial strength. Adequate reserves directly affect the District's bond rating and ultimately the ability to access debt markets at favorable interest rates, thereby ensuring the ability to finance and construct the infrastructure necessary to renew existing systems and expand water and wastewater service levels to meet future needs.

This Policy is intended to ensure MCWD has sufficient funds to meet current and future needs. Annually during the budget adoption process, the District Board of Directors (the “Board”) will approve appropriate levels and uses for reserve funds based upon the needs of the District.

2. General Provisions

The District may maintain its liquidity and capital funds in separate, designated sub-accounts in a manner that ensures its financial soundness and provides transparency to its ratepayers. The Fund balances are considered the minimum necessary to maintain the District's creditworthiness and adequately provide for:

- Compliance with applicable statutory requirements
- Financing of future capital facilities
- Financing of repair and replacement of existing assets
- Cash flow requirements
- Economic uncertainties and other financial hardships or downturns in the local or national economies

- Unexpected local disasters, such as earthquakes, fires, etc., or system failures
- Contingencies or unforeseen operating or capital needs

In the context of funding future capital facilities and maintaining and replacing existing assets, in each instance, the District will analyze the benefits and tradeoffs of utilizing reserves, pay-as-you-go and debt financing, or some combination of each, and determine the optimal funding strategy. The analysis should consider MCWD's current and projected reserve levels, as well as the impact of inflation, the costs of operations, and the cost to implement the capital improvement program. MCWD may from time to time measure its liquidity position by calculating "days cash" or other appropriate calculation of liquidity and its capital positions, as measured by its debt to equity ratio or other appropriate calculation of capital position.

MCWD has established and will maintain the following categorization of reserve funds:

- **Restricted Funds** – comprised of proceeds from the sale of bonds, or any form of debt, shall be retained in the appropriate bond proceeds fund as governed by the corresponding bond documentation. Additionally, monies from other agencies, or transfers from the Capital Replacement and Improvement Fund to fund costs associated with uncompleted prior years' projects; customer deposits; and capacity charges.
- **Board Designated Funds** – comprised of the Rate Stabilization Fund, the Capital Replacement and Improvement Fund, the Emergency Fund, the Administrative & General Fund and the Operating Reserve Fund

This Policy requires the crediting of interest income to the specific reserve funds until the respective fund's maximum is achieved. Once the maximum balance is reached within a specific reserve fund, the surplus interest earnings will be reallocated to other reserve funds whose funding level is below the maximum requirement recommended by this Policy. In determining the transfers of excess monies, priority will be given to fund the Operating Reserve and Emergency Reserve. In the event the balance in either the Operating Fund or Emergency Fund exceeds the established aggregate maximum, excess monies will be transferred annually into the Capital Replacement and Improvement Fund.

The minimum established for each Fund represents the baseline financial condition that is acceptable to MCWD from risk and long-range financial planning perspectives. Maintaining reserves at appropriate levels is a prudent, ongoing business process that consists of an iterative, dynamic assessment and application of various revenue generating alternatives. These alternatives (either alone or in combination with each other) include, but are not limited to: fees and charges, water usage, capital financing, investment of funds, and levels of capital expenditures. Balances in the Capital Reserve Fund, Capacity Charge Reserve Fund, Capital Replacement and Improvement Fund, or Rate Stabilization Fund may fall to zero; however, such shall not constitute a failure to comply with this Policy.

This Policy is designed to meet requirements at the District level. The District recognizes the differences in capital and liquidity needs between the Central Marina community and the Fort Ord community. Additionally, the District recognizes the differences in capital planning and liquidity requirements between the water and sewer systems. The District will continue to maintain distinct records and accounts for amounts determined under this Policy attributable to each component system. For purposes of this Policy the Component Systems are Marina Water, Marina Sewer, Ord Water, Ord Sewer and the New Water System.

Compliance with this Policy will be measured at the District level, however, in furtherance of compliance with this Policy and equity between rate payers of each community, and costs differences between the RUWAP System and the water and wastewater systems, the District may take into account the specific fund balances associated with each Component System and shall take any legally authorized action necessary to ensure the compliance and equity intended hereunder.

The Board shall approve any reallocation of funds or any transfers among Funds.

3. **Fund Target Levels and Management**

I. RESTRICTED FUNDS

- a. Bond Proceeds Fund(s): Bond proceeds funds are monies derived from the proceeds of a bond issue. Typically they consist of construction fund monies, and a debt service reserve fund (“DSRF”). The use of these proceeds is restricted by conditions set forth in the governing bond documents. These funds are usually held by the Trustee in favor of the bond holders.

Target Level – Any DSRF is established at the time of the bond issue; however if allowed under the governing documents, this amount may be recalculated and any excess principal and/or interest earnings will be used to pay debt service on the corresponding bonds.

Events or Conditions Prompting the Use of the Fund(s) – As stipulated in the respective bond documents. Construction fund monies are expected to be spent on applicable projects, while the DSRF can only be used in the event of a shortfall in revenues to pay debt service or to pay down principal at maturity, or in connection with a refunding transaction.

Periodic Review Dates for Balances – Any DSRF amount shall be reviewed by MCWD staff on a semi-annual basis (i.e., every interest and/or principal payment date).

- b. Capital Reserve Fund: The purpose of this fund is to hold funds that are intended for general use on capital projects. The funds come from contributions from other agencies or from funds that were budgeted for capital projects in prior years but

unspent. This fund is spent directly on capital expenditures over the current or future year's normal capital budget and is not held in reserve for some other purpose.

Target Level –The balance in this account will fluctuate depending on the capital improvement plan and the timing of projects. Therefore, no minimum or maximum levels will be established.

- c. Capacity Charge Reserve Fund: The monies in this fund are collected from developers to pay for the new facilities necessary to deliver water and wastewater service to newly developed property. These fees are for offsite improvements such as the development's fair share cost of wells, reservoirs, transmission mains, treatment plant capacity, wastewater facilities and other necessary facilities. The fees are collected at rates established by the Board based upon specific financial rate studies. The rates charged are based on a project's equivalent dwelling unit (EDU) basis. These funds are restricted to the design and construction of capital facilities for water and wastewater delivery. This Capacity Charge Reserve Fund is drawn upon as planned capital expenditures amounts are made. At the end of each fiscal year, any unspent budgeted capital amount will be reallocated to this fund and will be used in the following year's capital budget as appropriate and necessary.

Target Level –The balance in this account will fluctuate depending on the number and timing of development projects. Therefore, no minimum or maximum levels will be established.

II. BOARD DESIGNATED RESERVE FUNDS

- a. Capital Replacement and Improvement Fund: The Capital Replacement and Improvement Fund shall be used for the funding of the replacement of capital assets when they reach the end of their useful lives, or improvements to any Component System.

Target Level –Annually MCWD will strive to fund the Capital Replacement and Improvement Fund, based on availability of funds, with an amount equal to the result of multiplying (a) the depreciation amount for the prior Fiscal Year by (b) an amount equal to up to 40% for the Marina Community and 20% for the Fort Ord Community. There shall be no minimum or maximum balance for the Capital Replacement and Improvement Fund. MCWD may set aside replacement or improvement monies on a project-by-project basis.

Events or Conditions Prompting the Use of the Fund – Staff will recommend new assets to be constructed or assets to be replaced during the annual budget preparation. As projects are approved, funds will be appropriated from this reserve fund as necessary. Funds may be transferred from this account to the Capital Reserve Fund per the intent of that fund.

- b. Administrative & General Fund: The Administrative & General Fund can be used to fund certain general, administration and overhead projects. It is intended to fund, or partially fund offices, fixtures, furnishings, vehicles and equipment on a pay-as-you-go basis. The Board will appropriate funds for specific projects.

Target Level – This fund shall have a minimum balance of \$50,000 to be funded by June 30, 2017. However, MCWD shall authorize a maximum balance of \$250,000. Annually if approved by the Board the maximum balance in this fund may be adjusted for inflation. Special projects can be funded on an as-needed or project-by-project basis.

Events or Conditions Prompting the Use of the Fund – Administrative and general projects will be identified by staff and recommended to the Board during the preparation of the annual budget. As projects are approved, funds will be appropriated from available revenues.

Replenishment – in the event this fund falls below its minimum funding level, the Board will act to increase revenues to restore the balance above the minimum funding level within twenty-four (24) months from the date that the fund fell below the minimum level.

- c. Emergency Fund: The Emergency Fund shall be used to repair the water or sewer systems after a catastrophic event, such as an earthquake or fire, or system failure, or in connection with a financial crises, while long-term financing is being arranged or insurance claims are being processed. MCWD may use funds herein for either capital or operating purposes.

Target Level – Funding shall be targeted at a minimum equal to 1/2% of the net capital assets of the District's water and sewer systems and a maximum of 2% of the net capital assets of the water and sewer systems. The District shall have until June 30, 2017 to fund the account at the minimum level.

Events or Conditions Prompting the Use of the Fund – The Board may designate use of this fund after establishing that conditions exist as provided in the definition and purpose of the fund.

Replenishment – in the event the Emergency Fund falls below its minimum funding level, the Board will act to increase revenues to restore the balance above the minimum funding level within twelve (12) months from the date that the fund fell below the minimum level.

- d. Rate Stabilization Fund: This fund is governed by bond covenants for the District's revenue bonds. The purpose of the fund is to assist in smoothing rates to pay MCWD debt service and to assure that minimum debt service coverage ratios required by the District's bond covenants would be met in the future. Funds deposited into this reserve

are treated as operating revenues in the year of deposit and will be treated as such in years of use for the purposes of computing the District's debt service coverage ratio. This fund is applied in the five-year financial plan and annual rate model along with other reserve funds, if necessary, to smooth future rate increases. This fund will provide a buffer should revenue estimates in any year not meet projections. This fund will be drawn down to smooth rate increases. Specifically, they will be applied in any year where other revenues are not sufficient to meet the required debt service coverage ratio. They will also be applied if meeting only minimum coverage levels could result in the District's bond ratings being downgraded.

Target Level – This fund shall have no minimum or target level established. This fund is intended to be used to defray any unforeseen decreases in the sale of water, or long term increases in the cost of operating the Water and Sewer Enterprises. The Board upon the recommendation of staff, on a case by case basis, will determine the amount and timing for the funding of the Rate Stabilization Fund. The District shall establish a maximum funding level equal to 25% of annual aggregate debt service on all outstanding senior and subordinate debt.

Events or Conditions Prompting the Use of the Fund – This fund is intended to be used to defray any decline in revenues, or increase in operating expenses. The Board upon the recommendation of staff, on a case by case basis, will determine the amount and timing for any use of the Rate Stabilization Fund.

- e. Operating Reserve Fund: The Operating Reserve Fund is used for unanticipated operating expenses and is designated to be utilized for current operations and to meet routine cash flow needs.

Target Level – The Operating Reserve Fund shall have a minimum balance equal to 25% of the District's currently budgeted total operating expenses excluding depreciation and the maximum amount shall not exceed 50% of the currently budgeted total operating expenses excluding depreciation.

Events or Conditions Prompting the Use of the Fund – This fund may be routinely utilized by staff to cover temporary cash flow deficiencies caused by (i) timing differences between revenue and expenses; or (ii) unexpected decreases in revenues; or (iii) unexpected increases in expenses.

Replenishment – in the event the Operating Reserve Fund is at or below the minimum level, the Board will take appropriate action to increase revenues to restore the balance above the minimum within twelve (12) months from the date that the amount fell below the minimum level.

4. Investment Guidelines

Maintaining a prudent balance between funding capital projects with reserves, debt and annual cash flow sources may provide an added benefit to MCWD in terms of allowing

for a more optimal investment strategy. In the context of these policies and in circumstances where such balance is present, the investment portfolio can be separated into short and long portfolios to maximize investment returns. Because of their nature and potential imminent needs, amounts in the Capital Reserve, Emergency Reserve, and Operating Reserve should be invested in short-term instruments. Monies in the Capital Replacement and Improvement Reserve, however, may be invested to match needs as projected by the capital improvement plan. For purposes of investment, the District may commingle amounts on deposit in Board Designated Reserve Funds, so long as the District's Investment Policy permits such.

5. **Delegation of Authority**

The Board has sole authority to amend or revise this Policy. Through approval of this Policy, the Board has established written procedures for staff to follow in the management of the District's Reserve Funds.